

UNITED STATES DISTRICT COURT
DISTRICT OF NEVADA

DR. RONALD SLAUGHTER,)	Case No.: 2:10-cv-00437-GMN-PAL
)	
Plaintiff,)	ORDER
vs.)	
)	
LABORATORY MEDICINE)	
CONSULTANTS, LTD., <i>et al.</i> ,)	
)	
Defendants.)	

INTRODUCTION

Before the Court is Defendants Laboratory Medicine Consultants, Ltd. (LMC), Mark Goldstein, Esq., Dr. Marcus A. Erling, Dr. James E. Beecham, Dr. Jonathan H. Hughes, Dr. Jerry W. Hussong, Dr. Steven E. Kolker, Dr. David P. Marmaduke, Dr. Todd C. Murray, Dr. Steven M. Ruhoy, Dr. June D. Sigman, Dr. James L. Unger, and Dr. Noel S. Yumiaco's Motion to Dismiss (ECF No. 4). Plaintiff, Dr. Ronald Slaughter filed a Response on May 3, 2010 (ECF No. 8) and Defendants filed a Reply on May 13, 2010 (ECF No. 9).

Also before the Court is Defendant Aurora Diagnostics, LLC's Motion to Dismiss (ECF No. 7). Plaintiff filed a Response on May 13, 2010 (ECF No. 10) and Defendant Aurora filed a Reply on May 25, 2010 (ECF No. 11).

Having considered the pleadings and arguments the Court hereby GRANTS both Motions to Dismiss (ECF No. 4 & ECF No. 7).

FACTS AND BACKGROUND

LMC is a Nevada professional corporation which was formed in 1969 and operates as a pathology practice. Dr. Slaughter worked at LMC for 31 years and retired June 30, 2006. LMC redeemed all of Dr. Slaughter's stock in accord with the parties' 2001 Stockholders'

1 Agreement at that time. (*See* 2001 Stockholder's Agreement, Ex. C-1, pg. 8, Section 8 ECF
2 No. 4–3 (“ . . . upon . . . termination of employment of a Stockholder . . . the Corporation
3 shall redeem all of the affected Stockholder's Shares . . . ”)). Under the 2001 Stockholder's
4 Agreement, a portion of Slaughter's deferred compensation benefits was to be secured by an
5 escrow of Dr. Slaughter's stock. (*See id.* at pg. 15, Section 11B(a)(ii), (“ . . . until the
6 Withdrawing Stockholder has received his or her full compensation under this section, his or
7 her shares of stock shall be held in escrow to secure payment.”) The parties dispute whether
8 Dr. Slaughter's shares were ever placed in escrow. The parties also dispute if the redeemed
9 stock became treasury stock by operation of Nevada law in which case the treasury stock is
10 not considered outstanding stock for any purpose.

11 Sometime after Dr. Slaughter's retirement, Defendant Aurora Diagnostics LLC
12 (“Aurora”) made an unsolicited proposal to purchase 100% of the equity of LMC and retain
13 the active LMC pathologists as employees. The deal closed on December 10, 2007. Dr.
14 Slaughter alleges that his shares were not properly placed in escrow and Defendants
15 conspired to defraud him of the value of his shares during the sale of LMC to Aurora. Dr.
16 Slaughter filed suit in state court in March 2007 and then brought an arbitration case against
17 LMC on September 7, 2007. The arbitration case was continued at Dr. Slaughter's request
18 and Dr. Slaughter then filed this case on March 30, 2010. The arbitration case was still
19 pending as of the date of Defendants' motion so Plaintiff petitioned this Court to stay the
20 arbitration, but this Court denied Plaintiff's request. (ECF No. 18).

21 Dr. Slaughter asserts claims for §78j(b) and Rule 10b-5 federal securities violations,
22 as well as state law claims for breach of contract, conversion, civil conspiracy, breach of the
23 implied covenant of good faith and fair dealing, and breach of fiduciary duty. Defendants
24 argue for dismissal based on a number of reasons including Plaintiff's lack of standing to
25 assert a securities fraud violation.

DISCUSSION

A. Legal Standard

Federal courts are courts of limited jurisdiction and they can adjudicate only those cases that the Constitution and Congress authorize them to adjudicate. *Kokkonen v. Guardian Life Ins. Co. of America*, 511 U.S. 375, 377, 114 S.Ct. 1673 (1994). Rule 12(h)(3) of the Federal Rules of Civil Procedure provides that “[i]f a court determines at any time that it lacks subject-matter jurisdiction, the court must dismiss the action.” Fed. R. Civ. Pro. 12(h)(3) (2008).

Jurisdiction to consider claims brought under the Securities Exchange Act of 1934 is vested exclusively in the federal courts. 15 U.S.C. § 78aa; *Securities Investor Protection Corp. v. Vigman*, 764 F.2d 1309 (9th Cir. 1985). Section 10(b) of the Securities Exchange Act of 1934 makes it unlawful:

for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78(j). Rule 10b-5 provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary to make the statements made in the light of the circumstances under which they were made, not misleading, or

1 (c) To engage in any act, practice, or course of business which
2 operates or would operate as a fraud or deceit upon any person in
connection with the purchase or sale of any security.

3 17 C.F.R. §240.10b-5.

4 A cause of action under section 10(b) applies only to misrepresentations or omissions made
5 “in connection with the purchase or sale of any security.” 15 U.S.C. § 78j(b); *Binder v.*
6 *Gillespie*, 184 F.3d 1059, 1066 (9th Cir. 1999). Only a purchaser or seller of securities has
7 standing to bring action under section 10(b) and Rule 10b-5. *Id.* (citing *Blue Chip Stamps v.*
8 *Manor Drug Stores*, 421 U.S. 723, 749, 95 S.Ct. 1917 (1975); *See also Shivers v. Amerco*,
9 670 F.2d 826, (9th Cir. 1982) (Under federal antifraud rule, only a purchaser or seller of
10 securities may bring a suit for damages.).

11 **B. Standing**

12 Plaintiff brings this action in federal court based on alleged violations of Sections
13 10(b) and 20(a) of the Securities Exchange Act of 1934 (15 U.S.C. § 78j(b) and 78t(a)) and
14 Rule 10b-5 promulgated thereunder by the Securities and Exchange Commission (17 C.F.R.
15 § 240.10b-5). As Plaintiff is alleging a securities violation, in order for Plaintiff to have
16 standing in this case he must allege that either he purchased or sold a security (in this case
17 his LMC stock). *Binder*, 184 F.3d at 1066.

18 Plaintiff does not state any facts in his complaint that amount to him either selling or
19 purchasing LMC stock. Instead Plaintiff alleges that either (1) his shares of stock were never
20 transferred or held in escrow by LMC (Complaint ¶ 34, ECF No. 1) or (2) his shares of LMC
21 stock were wrongfully converted from Dr. Slaughter to LMC (*Id.* at ¶ 41) or (3) his shares of
22 outstanding stock in LMC disappeared (*Id.* at ¶ 44). Under Plaintiff’s first claim for relief
23 alleging violations under Section 10(b) and Rule 10b-5, he alleges that “[t]he actions of
24 Defendants and each of them and their representatives as herein alleged were done to carry
25 out a plan, scheme and course of conduct to intentionally defraud Dr. Slaughter by Aurora

1 purchasing 100% of the capital stock of LMC **without purchasing Dr. Slaughter's 100**
2 **outstanding shares** thereby enriching themselves to the detriment of Dr. Slaughter.”
3 (emphasis added). As demonstrated here, Plaintiff's Complaint is fatally flawed due to lack
4 of standing.

5 Plaintiff argues that one does not have to be a purchaser or seller of a security to have
6 standing to bring a securities law violation. Plaintiff explains that the alleged harm occurred
7 when the Defendants “allegedly caused Dr. Slaughter's stock to be “redeemed” on December
8 10, 2007 for \$10,000 while at the same time selling their own stock to Aurora Diagnostics
9 with each individual doctor receiving \$4,304,545.46.” (Response 14:23–26, ECF No. 8).
10 Plaintiff asserts that this is enough to establish standing relying on *Brown v. Ivie*, 661 F.2d
11 62 (5th Cir. 1981).

12 In *Brown*, the Fifth Circuit Court of Appeals reversed a district court decision which
13 held that Plaintiff's complaint failed to state a claim under federal securities law. *Id.* at 67.
14 The Court of Appeals held that Plaintiff did state a claim explaining:

15 A necessary element of a Rule 10b-5 offense is that the fraud or
16 deceit be “in connection with” the sale of a security. . . . [T]he
17 “plaintiff in a Rule 10b-5 case need not establish a direct or close
18 relationship between the fraudulent transaction and the purchase
19 or sale, but only that the transaction (involving the sale) ‘touch’
20 the transaction involving the defendant's fraud.” Whether
21 fraudulent omissions or misrepresentations are too remote to be
“in connection with” the sale of a security depends upon the
individual facts of each case. . . . [W]e conclude that the alleged
fraud by the defendants was made “in connection with” the sale
of a security.

22 The plaintiff in *Brown* had refused to sell his stock back to the corporation pursuant to a buy-
23 sell agreement. The alleged fraud in that case involved requiring the plaintiff to enter into
24 the buy-sell agreement so that he would be forced to sell his stock when the defendants fired
25 him seven days later. In holding that the plaintiff has stated a claim the court found that:

1 “[s]ince a contract for the sale or disposition of stock constitutes a sale of a security for
2 purposes of the federal securities laws, 15 U.S.C. §§ 77b(3) and 78c(a)(14), the defendants’
3 fraud, as alleged, is “in connection with” the sale of a security. Nowhere in the opinion does
4 the court discuss the plaintiff’s standing or lack thereof.

5 Contrary to the plaintiff in *Brown*, Plaintiff in this case does not allege that he was
6 forced to sell his stock or even that it was sold. Plaintiff alleges harm based on Defendants’
7 actions in either not placing the stock in escrow or placing the stock in escrow and then
8 converting it. (Complaint ¶ 73). Plaintiff’s alleged injuries were not caused by his purchase
9 or sale of securities. The mere involvement of shares of stock does not bring a transaction
10 within Rule 10b-5. *See Desert Land, LLC v. Owens Financial Group, Inc.*, 154 Fed.Appx.
11 586 (9th Cir. 2005) (“[T]he mere allegation that a contractual breach involved a security
12 does not confer standing to assert a 10b-5 action.”); *Mills v. Polar Molecular Corp.*, 12 F.3d
13 1170, 1176 (2d Cir.1993) (“The failure to carry out a promise made in connection with a
14 securities transaction is normally a breach of contract.”); *Gigliotti v. Mathys*, 129 F.Supp.2d
15 817, 823 (D.Vi.2001) (holding that “mere involvement of shares of stock does not bring a
16 transaction within Rule 10b-5, unless the value of the securities (or consideration) involved
17 is misrepresented”). Therefore, Plaintiff lacks standing to bring a claim under Section 78(j)
18 or Rule 10b-5 for a federal securities violation and his first claim for relief must be
19 dismissed.

20 Plaintiff’s second claim for relief must also be dismissed. “To establish a claim under
21 section 20(a) of the Exchange Act, a plaintiff must allege: (1) a primary violation of the
22 federal securities laws; and (2) that the defendants possessed, directly or indirectly, power or
23 control over the primary violator.” *Brown v. Kinross Gold, U.S.A.*, 343 F.Supp.2d 957 (D.
24 Nev. 2004). As this court has ruled that Plaintiff’s first claim fails because Plaintiff lacks
25 standing to assert federal securities claims, Plaintiff’s second claim also fails because the

1 underlying securities violation necessary to state a section 20(a) claim is lacking. *See id.*

2 As a result of this Court's dismissal of Plaintiff's claims for federal securities
3 violations, this Court no longer has subject matter jurisdiction. Plaintiff's remaining claims
4 arise under state law. "A federal court cannot exercise supplemental jurisdiction over state-
5 law claims if the federal court lacks original jurisdiction in the case." *Desert Land*, 154
6 Fed.Appx. at 588. Accordingly, Plaintiff's Complaint must be dismissed in its entirety.

7 Finally, the Court finds that it would be futile to allow plaintiff to amend his
8 complaint to allege federal securities violations. Plaintiff avoided any opportunity to allege
9 that he sold his shares (in fact Plaintiff has been careful not to allege that he sold his shares)
10 and should not be allowed to make a complete one-eighty turn to allege that he did sell his
11 shares. Therefore the Court will dismiss Plaintiff's Complaint with prejudice.

12 **C. Statute of Limitations**

13 Alternatively, assuming Plaintiff has standing because the fraud occurred in
14 connection with the sale of a security, his claim is nonetheless time barred by the statute of
15 limitations. Federal securities claims are time barred pursuant to 28 U.S.C. §1658(b)(1),
16 which provides that such claims must be filed "not later than the earlier of (1) 2 years after
17 the discovery of the facts constituting the violation; or (2) 5 years after such violation." The
18 Supreme Court recently held that discovery of the facts constituting the violation occurs
19 when the plaintiff actually discovers the facts constituting the violation, or when a
20 reasonably diligent plaintiff would have discovered the facts constituting the violation-
21 whichever comes first. *Merck & Co., Inc. v. Reynolds*, — U.S. —, 130 S.Ct. 1784, 1790
22 (2010).

23 Plaintiff claims that he did not become aware of all the necessary facts regarding how
24 his stock was converted until the middle of 2009. Plaintiff's complaint alleges that his shares
25 were wrongfully converted and not placed into escrow. He further explains that because his

1 shares were not properly placed into escrow, his shares were not purchased by Aurora,
2 causing Plaintiff to suffer damages.

3 However, Defendants' evidence demonstrates that a reasonable plaintiff would have
4 been aware of the facts necessary to allege a federal securities violation by December of
5 2007. In September 2007 Plaintiff's attorney, David Merrill, sent a letter questioning
6 whether Plaintiff's shares were being held in escrow. (*See* 9/13/07 Letter, Ex. A-3, ECF No.
7 4). Mark Goldstein, on behalf of LMC, responded with a letter sent to Plaintiff on
8 September 18, 2007 which states unequivocally that Dr. Slaughter is not a stockholder, but a
9 secured creditor and that his shares were redeemed under Section 8 of the 2001 Agreement
10 and were not counted as outstanding under N.R.S. 78.283. (*See* 9/18/07 Letter, Ex. A-4, ECF
11 No. 4). An e-mail written to the LMC retiree shows that Plaintiff knew that LMC may not
12 have put his shares into escrow on September 25, 2007. (*See* 9/25/07 e-mail, Ex. B-21, ECF
13 No. 4-1). By December 11, 2007, Plaintiff knew that the Aurora stock sale transaction took
14 place on December 10, 2007. (*See* 12/11/07 email, Ex. B-24, ECF No. 4-1). Thus by the end
15 of December Plaintiff was aware that his shares might not have been placed in escrow, that
16 LMC claimed to have "redeemed" his shares, that his shares were not being considered as
17 outstanding shares, and only the outstanding shares of LMC were being purchased by
18 Aurora. Plaintiff's complaint does not allege anything more than this.

19 Based on the allegations put forth by Plaintiff to state a securities fraud violation,
20 Defendants have demonstrated sufficient facts to show that a reasonable plaintiff would have
21 been aware of all the necessary facts by late December 2007. Plaintiff's blanket statement
22 that he was not aware of all of the necessary facts regarding how his stock was converted is
23 not adequate to overcome Defendants proof. Plaintiff does not explain what was missing
24 from the above information and reviewing Plaintiff's complaint there is nothing more alleged
25 to show that Plaintiff did not know that his shares were either not in escrow or would not be

1 included in the Aurora stock purchase transaction by December 2007. Plaintiff did not file
2 this suit until March 30, 2010, more than two years after December 2007. Accordingly, the
3 Court finds that Plaintiff's claims of a securities violation under Section 10(b) and Rule 10B-
4 5 are time barred pursuant to 28 U.S.C. §1658(b)(1). Since Plaintiff's claim of a federal
5 securities violation is time barred, this Court does not have subject matter jurisdiction over
6 this case and it must be dismissed for the reasons given *supra*.

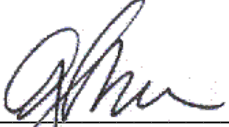
7 **CONCLUSION**

8 **IT IS HEREBY ORDERED** that Defendants Laboratory Medicine Consultants, Ltd.
9 (LMC), Mark Goldstein, Esq., Dr. Marcus A. Erling, Dr. James E. Beecham, Dr. Jonathan H.
10 Hughes, Dr. Jerry W. Hussong, Dr. Steven E. Kolker, Dr. David P. Marmaduke, Dr. Todd
11 C. Murray, Dr. Steven M. Ruhoy, Dr. June D. Sigman, Dr. James L. Unger, and Dr. Noel S.
12 Yumiaco's Motion to Dismiss (ECF No. 4) is **GRANTED**.

13 **IT IS FURTHER ORDERED** that Defendant Aurora's Motion to Dismiss (ECF No.
14 7) is also **GRANTED**.

15 Plaintiff's Complaint is **DISMISSED with prejudice**.

16 DATED this 19th day of April, 2011.

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19 _____
20 Gloria M. Navarro
21 United States District Judge
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